GCOS

Great Canadian
Oil Sands Limited
Annual Report
1972

Great Canadian Oil Sands Limited

DIRECTORS
(as at December 31, 1972)
Alex E. Barron
Darwin W. Ferguson
Kenneth F. Heddon
Walter C. Huffman
Reginald D. Humphreys
Robert McClements, Jr.
Maurice B. Parmelee
W. Harold Rea
J. Grant Spratt
Donald J. Wilkins

OFFICERS
(as at December 31, 1972)
W. Harold Rea
Chairman of the Board
Kenneth F. Heddon
President
Reginald D. Humphreys
Vice-President and General Manager
Darwin W. Ferguson
Vice-President
Walter C. Huffman
Vice-President
Ardagh S. Kingsmill
Secretary
Maurice B. Parmelee
Treasurer
Wilfred C. Blood
Comptroller
Anthony A. L. Wright
Assistant Treasurer and
Assistant Secretary

HEAD OFFICE
85 Bloor Street East
Toronto, Ontario

TRANSFER AGENT AND REGISTRAR
The Canada Trust Company
110 Yonge Street, Toronto, Ontario
10150 100th Street, Edmonton, Alberta
528 8th Avenue S.W., Calgary, Alberta

SOLICITORS
Tilley, Carson & Findlay
Toronto, Ontario

ANNUAL MEETING
The Annual Meeting of Shareholders will be held in the Eldorado Room, Hotel Macdonald, 100th Street and Jasper Avenue, Edmonton, Alberta at 10:30 a.m. (Edmonton time) on Tuesday, June 19, 1973.

Report of the directors
to the shareholders and employees

The Year in Review

Your Company made substantial progress during 1972 in terms of increased production, added revenues, fewer operating problems and reduced losses. Despite these marked improvements, several critical problems still demand solution before an acceptable return on shareholders' equity can be achieved.

Improved equipment performance enabled GCOS to reach a new high in sustained operations. This, in turn, was reflected in the production of synthetic crude which reached 18,614,000 barrels, a 21 per cent improvement over 1971 when production was 15,400,000 barrels. Daily average production increased to 50,900 barrels compared to 42,200 barrels for the year earlier.

The increased production level helped to cut losses sharply from $8,246,000 in 1971 to $680,000. Revenues were up, reaching $62,284,000. In 1971, revenues totalled $50,724,000.

In addition to higher production, the financial progress is chiefly attributable to improved management of costs and greater operating efficiency. A crude price increase of 10¢ per barrel in November improved fourth quarter results slightly.

The new overburden removal program, involving the use of 150-ton trucks and 15-cubic-yard front-end loaders, recorded its first full year of operation in 1972. Implemented in late 1971 at a cost of approximately $10 million, it has been instrumental in reducing the unit cost of overburden removal despite increases in labour costs and other factors. Over the course of the year, 13 million cubic yards of overburden were excavated, representing a new high for this activity.

During 1972, capital spending totalled $10.1 million with the mine and employee housing taking the biggest amounts. In addition to expenditures for a variety of miscellaneous equipment, almost $1.5 million were required for additional conveyors. Housing capital costs for 1972 reached $2.7 million with the completion of 152 new housing units.

Late in 1972 plans were completed to add a duplicate conveyor system parallel to the existing final conveyor into the extraction plant. This system, costing about $4 million, will improve the mine's capability of maintaining a continuous flow of oil sand to the extraction plant. It replaces the

smaller supplemental system installed in 1970 which will be used elsewhere in the plant when the sands adjacent to it have been mined. The new conveyor system can be fed by the bucketwheel excavators on either bench as well as by supplemental mining equipment. Completion is expected in September, 1973.

GCOS applied to the Alberta Energy Resources Conservation Board in 1972 for an increase in its authorized output from 45,000 barrels to 65,000 barrels per day. A hearing was held in January, 1973 and a decision has not yet been received on this most vital issue. Our record production of 18,614,000 barrels in 1972 was within authorized limits because we were allowed to make up certain underproduction from prior years, but unless an increase is granted, the authorized GCOS annual production for 1973 and future years would be at the significantly lower level of 16,425,000 barrels and our efforts to eliminate losses and the deficit would be futile.

We are, of course, hopeful that a favourable decision will soon be announced. Since some months have seen from 55,000 to 60,000 barrels per day of sustained production, we should be able to reach higher levels of output with only minor modifications to existing facilities and no substantial additional outlay of capital funds would be contemplated.

A number of reasons have already been cited for the gains made in 1972. One which has not been mentioned is the continuing dedication and skills of our employees. Their efforts over the past year are deeply appreciated. Along with your Company, they are pioneering a new source of energy and their efforts are contributing greatly toward the increasing maturity of our industry.

Future Outlook

Though operations during 1972 give cause for optimism, the problems facing your Company are still formidable. One of the most compelling is the need to further reduce operating and maintenance costs and while gratifying progress has been made, we still must work diligently, not just to improve, but to avoid slipping backwards. Nearly all the goods and services needed by your Company have gone up in price over the past year, including the wages and fringe benefits paid employees.

These added costs can only be recovered through higher synthetic crude prices. Higher selling prices are also essential to the eventual profitability of your Company as well as its ability to internally generate sufficient cash to meet capital investment and debt repayment needs. The value of synthetic crude, however, is closely related to that of conventional crude. This relationship compels GCOS to rely heavily on higher conventional crude prices to improve its position. For example, the 20 cent-per-barrel conventional crude price increase announced in January this year allowed GCOS to increase its price by a like amount.

In discussing capital needs and higher operating costs, the issue of environmental protection must be considered. Environmental protection should be a primary consideration but it also is important that future regulations be realistic in terms of costs.

Presently GCOS meets its environmental protection responsibilities in a number of ways. One is through a written policy which charges each division and employee to exercise due care and precaution to control and prevent air and water pollution in the performance of all duties. In support of this policy is an employee training program. The Company also works with several environmental protection organizations, including the North Saskatchewan River Survey Group and the Canadian Petroleum Association Environmental Committee. And it is helping to train Department of Lands and Forests personnel in a co-operative oil spill contingency plan for the Fort McMurray area.

On the GCOS lease, studies are being undertaken to determine how tailings dykes can be treated to improve their ability to support vegetation. Grass and shrub planting have been underway on dyke walls for the past three years and several thousand young trees have been planted. Other factors entering into land reclamation also are being thoroughly studied.

Any discussion of GCOS problems must consider the question of royalties. At the time of this writing, the Province of Alberta has not renewed the temporary 50 per cent remission of royalties in effect during the last three years and has still not defined its new royalty policy with respect to the oil sands. GCOS fully supports the principle that the people of Alberta should participate in the development of their resources. Nevertheless, there must be broad recognition that extracting energy from the oil sands remains a costly pioneering venture and cannot, in any way, be considered a mature industry. As a consequence, the Government has a vital role to play in oil sand development through the establishment of realistic policies, particularly with respect to royalties.

Your Company has made its views on royalties known to the Government of Alberta on several occasions, and has urged the Province to consider levying royalties on raw bitumen as extracted from the sand rather than desulphurized, synthetic crude oil which has undergone substantial, costly processing. This would parallel the practice followed by the Government with respect to conventional crude oil where the royalties are assessed against the oil pretty well as it comes out of the ground. We sincerely hope that this and other factors are considered when the Province enunciates its new policy.

The Athabasca oil sands contain the seeds of a future major industry for Canada, with jobs for thousands and energy in abundance. The GCOS project alone has provided work for 1,500 men and women who, at the end of 1972, were receiving a yearly payroll totalling $21 million. As well, many more jobs have been created indirectly through purchases from numerous suppliers across Canada. To the end of 1972, GCOS had invested $545 million in capital and operating expenditures and $475 million of this amount had been spent in Canada. Governments at the federal, municipal and provincial level have received an estimated $143 million in taxes and royalties and the nearest town, Fort McMurray, has grown from 1,100 inhabitants to over 8,000 in population.

Yet, your Company has not received any return on its investment. Indeed, it had accumulated an $88 million deficit at the end of 1972. Whether or not that deficit is eliminated and a return on the investment is ever received will depend heavily on how each of the problems discussed here are ultimately resolved.

W. H. Rea

W. Harold Rea, *Chairman of the Board*

K. F. Heddon

K. F. Heddon, *President*

April 25th, 1973

Consolidated Balance Sheet

DECEMBER 31, 1972
(with comparative figures at December 31, 1971)

Great Canadian Oil Sands Limited

(Incorporated under the laws of Canada)

Assets

	1972	1971
Current:		
Cash	$ 115,000	$ 220,000
Accounts receivable —		
Trade (note 4)	5,645,000	4,483,000
Other (note 3)	511,000	345,000
Inventory of finished product, at estimated net realizable value	1,809,000	1,067,000
Inventory of material and supplies, at the lower of cost and net realizable value	8,005,000	6,100,000
Prepaid charges	883,000	1,038,000
Total current assets	16,968,000	13,253,000
Plant facilities and housing (note 5):		
Plant, buildings and equipment, at cost	207,967,000	206,216,000
Less accumulated depreciation	27,138,000	18,127,000
	180,829,000	188,089,000
Housing —		
Rental housing units, at cost (less accumulated depreciation 1972 — $488,000; 1971 — $1,207,000)	723,000	488,000
Housing under construction and serviced lots, at cost	1,286,000	1,546,000
Housing units to be sold under long-term instalment sale agreements with employees, at the lower of cost or selling price	627,000	425,000
Accounts receivable under long-term instalment sale agreements, for housing units sold to employees less current portion included in accounts receivable — other (notes 3 and 8)	13,252,000	10,620,000
Total plant facilities and housing	196,717,000	201,168,000
Deferred costs (note 5):		
Deferred development preproduction and start-up costs, less write-offs and amortization	60,107,000	62,443,000
Deferred overburden removal (stripping) costs	14,632,000	16,174,000
Total deferred costs	74,739,000	78,617,000
	$288,424,000	$293,038,000

On behalf of the Board:
W. H. Rea, Director
M. B. Parmelee, Director

(See accompanying notes to consolidated financial statements)

Liabilities

	1972	1971
Current:		
Accounts payable and accrued charges (note 4)	$ 8,127,000	$ 7,490,000
Current portion of long-term debt (note 3)	2,479,000	2,412,000
Demand loan payable to Sun Oil Company	5,800,000	9,400,000
Total current liabilities	16,406,000	19,302,000
Long-term debt, less amounts due within one year (notes 3 and 6):		
6% unsecured debentures (Alberta issue) due May 15, 1975	12,363,000	12,364,000
5¾% notes due July 1, 1991 (1972 — U.S. $44,000,000; 1971 — U.S. $46,000,000) translated at exchange rates prevailing at date of issue	47,317,000	49,468,000
6¼% - 9¾% mortgages payable on houses sold and to be sold and rental housing units (repayable over terms up to thirty years)	9,065,000	7,952,000
Total long-term debt	68,745,000	69,784,000
Total liabilities	85,151,000	89,086,000

Shareholders' Equity

Capital (note 7):		
Authorized —		
2,000,000 Voting Preferred Shares of $100 par value each consisting of		
500,000 First Preferred Shares		
500,000 Second Preferred Shares		
450,000 Third Preferred Shares		
550,000 Fourth Preferred Shares issuable in series		
35,000,000 Common Shares without nominal or par value		
Issued —		
7% Non-Cumulative Redeemable (at par) Preferred Shares		
500,000 First Preferred Shares	50,000,000	50,000,000
500,000 Second Preferred Shares	50,000,000	50,000,000
450,000 Third Preferred Shares	45,000,000	45,000,000
200,000 Fourth Preferred Shares, Series A	20,000,000	20,000,000
28,495,833 Common Shares (1971 — 28,495,761 shares)	126,199,000	126,198,000
	291,199,000	291,198,000
Deficit	(87,926,000)	(87,246,000)
Total shareholders' equity	203,273,000	203,952,000
	$288,424,000	$293,038,000

(See accompanying notes to consolidated financial statements)

Consolidated Statements of Income and Deficit

FOR THE YEAR ENDED DECEMBER 31, 1972
(with comparative figures for 1971)

Income

	1972	1971
Revenue:		
Value of synthetic crude and other products produced for sale	$61,644,000	$50,724,000
Other (note 9)	640,000	
	62,284,000	50,724,000
Costs and expenses:		
Costs, operating, administrative and general expenses (note 5)	48,713,000	46,489,000
Amortization of deferred development, preproduction and start-up costs (note 5)	2,336,000	1,931,000
Depreciation (note 5)	7,892,000	6,463,000
Interest on long-term debt	4,023,000	4,087,000
	62,964,000	58,970,000
Net loss for the year	$ 680,000	$ 8,246,000

Deficit

	1972	1971
Balance, January 1	$87,246,000	$79,000,000
Net loss for the year	680,000	8,246,000
Balance, December 31	$87,926,000	$87,246,000

(See accompanying notes to consolidated financial statements)

Consolidated Statement of Changes in Financial Position

FOR THE YEAR ENDED DECEMBER 31, 1972
(with comparative figures for 1971)

	1972	1971
Source of funds:		
From operations —		
Net loss for the year	$ (680,000)	$ (8,246,000)
Add expenses not requiring an outlay of working capital during the period:		
Depreciation (note 5)	7,892,000	6,463,000
Amortization of deferred development, preproduction and start-up costs (note 5)	2,336,000	1,931,000
Net reduction in deferred overburden removal costs (note 5)	2,163,000	
Total funds from operations	11,711,000	148,000
Federal sales tax remission (credited to fixed assets)	6,000,000	
Mortgages on houses (net)	1,113,000	1,591,000
Subscription payments received for fourth preferred shares		14,700,000
	18,824,000	16,439,000
Application of funds:		
5¾% notes maturing within one year	2,151,000	2,150,000
Plant facilities and housing	10,062,000	22,733,000
Net increase in deferred overburden removal costs		1,523,000
Inventory reclassified to fixed assets		813,000
	12,213,000	27,219,000
Increase (decrease) in working capital	$ 6,611,000	$(10,780,000)
Changes in components of working capital:		
Increase (decrease) in current assets —		
Cash	$ (105,000)	$ 48,000
Accounts receivable — trade	1,162,000	1,720,000
— other	166,000	(608,000)
Inventory of finished product	742,000	(200,000)
Inventory of material and supplies	1,905,000	(838,000)
Prepaid charges	(155,000)	(270,000)
	3,715,000	(148,000)
Decrease (increase) in current liabilities —		
Accounts payable and accrued charges	(637,000)	(1,209,000)
Current portion of long-term debt	(67,000)	(23,000)
Notes payable to Sun Oil Company	3,600,000	(9,400,000)
Increase (decrease) in working capital	$ 6,611,000	$(10,780,000)

(See accompanying notes to consolidated financial statements)

Notes to Consolidated Financial Statements

DECEMBER 31, 1972

1. Basis of statement presentation

The accompanying financial statements are prepared on a consolidated basis to include the accounts of Great Canadian Oil Sands Supply Limited, a wholly-owned subsidiary.

2. Authorized production

The company's authorized production of synthetic crude as fixed by Alberta is 16,425,000 barrels per year (45,000 barrels per day).

Under an arrangement respecting yearly under-production and over-production, the company in 1972 actually produced 18,614,000 barrels of synthetic crude, but future annual production is still limited to the presently authorized level of 16,425,000 barrels per year.

An application has been made by the company to the Energy Resources Conservation Board of Alberta to increase the authorized production to 23,725,000 barrels per year (65,000 barrels per day).

3. Reclassification of accounts

Amounts due within one year on accounts receivable under long-term sales agreements for housing units (1972 — $271,000; 1971 — $150,000) are now included in current assets (under the caption "Accounts receivable — other"); similarly amounts due within one year on mortgages payable on housing units (1972 — $479,000; 1971 — $407,000) are now included in current liabilities (under "Current portion of long term debt"). The 1971 comparative figures have been restated accordingly.

4. Accounts with affiliated companies

Included in accounts receivable and accounts payable are the following accounts receivable from, or payable to, Sun Oil Company (parent company) and its affiliates:

Accounts receivable	$2,254,000
Accounts payable and accrued charges	$ 563,000

5. Depreciation of plant facilities and housing and amortization of deferred costs

The company's productive facilities are being depreciated using a unit of production method based on estimated reserves. Furniture and fixtures and mobile equipment are being depreciated over their estimated useful life periods ranging from two to ten years. Rental housing units are being depreciated over five years (trailers) and twenty-five years (buildings). Deferred development, preproduction and start-up costs are being amortized against income using a unit of production method based on estimated reserves. Deferred overburden removal (stripping) costs are being charged to production on the basis of the area actually mined.

The depreciation provision for the year ended December 31, 1972 excludes depreciation of $1,512,000 (1971 — $538,000) on overburden removal equipment which was charged to deferred overburden removal (stripping) costs. On the other hand, operating costs for the period include $621,000 (1971 — Nil) (based on the area mined) in respect of depreciation previously charged to this deferred account.

6. Long-term debt

(a) 6% unsecured debentures (Alberta issue):

These debentures, which mature on May 15, 1975, comprise the following:

Debentures which are partially convertible (of which $3,971,100 are held by Sun Oil Company Limited)	$12,135,400
Debentures in respect of which the partial conversion privilege has been exercised	227,460
	$12,362,860

Subject to certain terms and conditions, the partially convertible debentures may, at any time before May 1, 1975, be converted into fully paid and non-assessable shares of the company on the following basis, that is, with respect to each $100 principal amount of the debentures, $32 thereof may be applied to the purchase of and converted into:

(i) Three shares before May 16, 1973, or

(ii) Two shares after May 15, 1973 and before May 1, 1975.

Holders resident in Alberta of unconverted debentures may require Sun Oil Company Limited to purchase, before April 1, 1975, their debentures at par plus accrued and unpaid interest.

(b) 5¾% notes due July 1, 1991:

The terms of the 5¾% notes require annual prepayments on July 1 of U.S. $2,000,000. The company is permitted to make optional additional annual prepayments of up to U.S. $2,000,000 commencing July 1, 1976 without premium. Prepayments in excess of the foregoing may in certain circumstances be made at 105.75% to June 30, 1976 and at reducing percentages thereafter.

7. Share capital — common shares

During the year seventy-two shares were issued upon the partial conversion of certain of the 6% unsecured debentures (Alberta issue). There are 364,062 shares reserved for possible issuance in future upon the partial conversion of the remaining debentures. A further 7,500 shares are reserved for possible issuance at $3 per share under an option granted to a director exercisable subject to certain terms and conditions on or before June 29, 1973.

8. Commitments and contingent liabilities

(a) The company is a party to an agreement with Sun Oil Company Limited and Abasand Oils Limited involving the sublease of Bituminous Sands Lease No. 86 (approximately 4,500 acres) in respect of which the company is operating its plant. Lease No. 86 runs for a term of twenty-one years from June 1, 1966 renewable for further terms each of twenty-one years so long as the plant is in operation and subject to such terms and conditions as may be prescribed at the time renewal is granted. The annual rental is $1 per acre. Under this agreement the company has also assumed an indebtedness to the Government of Canada of $1,802,107 in respect of certain wartime expenditures in the Athabasca Tar Sands area. Principal payments on this debt have been deferred on an interest free basis until 1978. As the company is hopeful of obtaining relief from this debt, no provision for this amount has been recorded in the accounts of the company.

(b) In addition to crown royalties payable on production, the company is obligated to pay Sun Oil Company Limited and Abasand Oils Limited (under the provisions of the sublease agreement referred to in (a) above) a basic royalty of 10¢ per barrel of bitumen extracted or recovered from bituminous sands from the leased land, together with additional royalties to Sun and Abasand in respect of synthetic crude oil under certain circumstances, and subject to a 50% increase in both royalties after the company's cash flow has equalled its total initial investment. As from April 1, 1970, Abasand has waived 50% of its share of the royalties for three years, and Sun has waived 100% of its share of the royalties until the earlier of the elimination of the company's deficit account or a determination that the financial results from the company's operations are satisfactory. In 1970 the Government of Alberta also agreed to the remission of 50% of the crown royalties payable by the company for a three year period beginning April 1, 1970.

(c) Under the provisions of the sale agreements covering the sale of housing units to employees, the company has undertaken, in the event of employee termination within ten or twelve years of the date of the sale agreement, to repurchase

the employee's housing unit. The potential net outlay under such repurchase commitments at December 31, 1972 would amount to approximately $655,000.

(d) The company is a party to long term agreements with Sun Oil Company Limited and with Shell Canada Limited pertaining to the sale of synthetic crude oil.

(e) The company's unfunded past service pension liability at December 31, 1972 is estimated at approximately $400,000. This amount is being funded and charged to income over a period of seventeen years.

9. Other revenue

Other revenue represents amounts received in 1972 from sales of certain technical information, feasibility studies, etc. In connection with such sales the company also received a sublease covering approximately 1,537 acres adjacent to Bituminous Sands Lease No. 86, to which no value has been attributed in the accounts.

10. Directors and officers

Eleven persons were directors of the company during 1972, only certain of whom were paid as such, and their remuneration aggregated $18,000. Ten persons were officers during 1972, only certain of whom were paid as such, and their remuneration aggregated $90,607. Seven such officers were also directors.

11. Net loss per common share

The net loss per common share amounted to $0.02 in 1972, and $0.29 in 1971. These amounts were calculated using the weighted average method for shares issued during the year. No adjustment has been made in the calculations for dividends on outstanding preferred shares as dividends on these shares are non-cumulative and none have been declared or paid to date. If the calculations were to assume the payment of a dividend of 7% on the preferred shares, the net loss per common share would have been $0.43 in 1972, and $0.66 in 1971.

Auditors' Report

To the Shareholders of
Great Canadian Oil Sands Limited:

We have examined the consolidated balance sheet of Great Canadian Oil Sands Limited and its subsidiary as at December 31, 1972 and the consolidated statements of income and deficit and changes in financial position for the year then ended.

Our examination included a general review of the accounting procedures and such tests of accounting records and other supporting evidence as we considered necessary in the circumstances.

In our opinion these consolidated financial statements present fairly the financial position of the companies as at December 31, 1972 and the results of their operations and changes in their financial position for the year then ended, in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

CLARKSON, GORDON & CO.
Chartered Accountants
Edmonton, Canada,
January 19, 1973.

This past year

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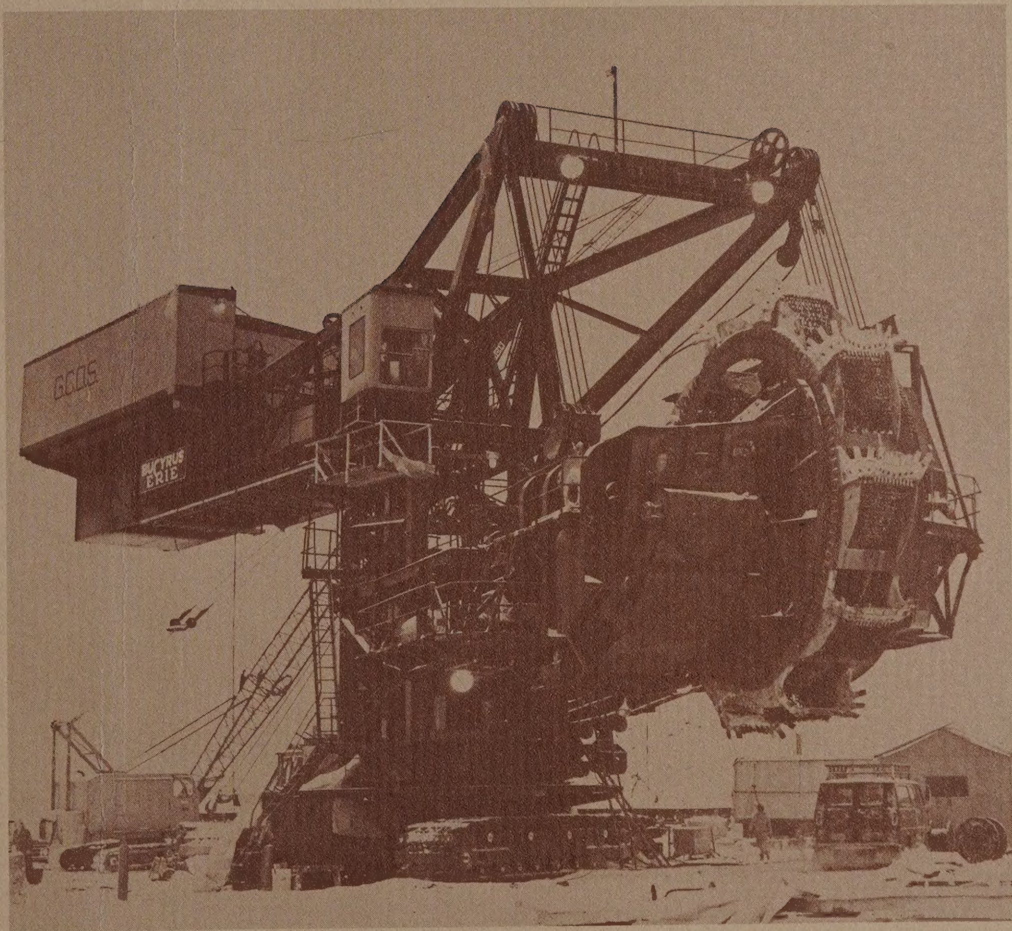

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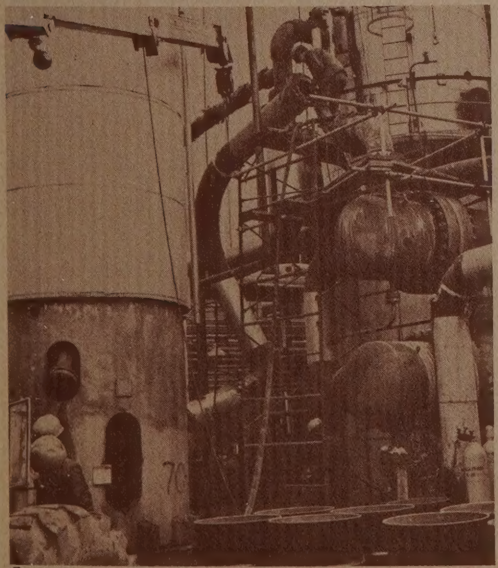

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1. Employees are trained to quickly clean up oil spills as part of Company's efforts to protect environment.

2. Thousands of visitors tour GCOS facilities each year. R. D. Humphreys, vice-president, greets a delegation from U.S.S.R.

3. Group of technical visitors receive a description of mining operation.

4. GCOS employees enjoy an active social life at Fort McMurray.

5. New outlet line is installed on naphtha unifiner, following change of catalyst.

6. Third bucketwheel went into operation last year as part of new supplemental mining program.

Great Canadian
Oil Sands Limited "Pioneering Oil Sand Development"